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In the Supreme Court of the United States

OCTOBER TERM, 1994

REGIONS BANK OF LOUISIANA, SUCCESSOR IN INTEREST OF SECOR BANK, FEDERAL SAVINGS BANK, JOINED IN BY BERNICE ELIZABETH HAAS AND THOMAS MILTON HAAS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

DAVID ENGLISH CARMACK
EDWARD T. PERELMUTER
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTION PRESENTED

Whether federal tax liens for which notice has been recorded after a competing lien on the property has been erroneously released retain priority when the lien is thereafter reinstated.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-42) is reported at 31 F.3d 1081. The opinion of the district court is reported at 173 B.R. 753. The opinion of the bankruptcy court is unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 13, 1994. The petition for rehearing was denied on November 3, 1994 (Pet. App. 43-44). On

January 17, 1995, Justice Kennedy extended the time for filing a petition for a writ of certiorari until March 23, 1995. The petition for a writ of certiorari was filed on March 22, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On January 4, 1979, Thomas and Bernice Haas executed a mortgage on their home as security for a loan from the predecessor of petitioner Regions Bank (Pet. App. 2). On March 31, 1986, the bank recorded a release of that mortgage (*ibid.*). The release stated that the mortgage was discharged because the underlying indebtedness had been satisfied in full (*ibid.*). The filing of the release extinguished the mortgage lien even though the underlying indebtedness had not in fact been satisfied. Ala. Code § 35-10-28 (1991); see Pet. App. 2.

After the date that the release was recorded, the Internal Revenue Service filed notices of federal tax liens on the property. The federal liens secured tax liabilities of $506,523 (Pet. App. 2-3). On October 7, 1991, the Haases filed a petition for relief under Chapter 11 of the Bankruptcy Code (Pet. App. 3). They thereafter initiated an adversary proceeding in the bankruptcy court to determine the extent and validity of the competing liens on their property (*ibid.*).

The bankruptcy court ordered the "equitable reinstatement" of the mortgage lien and further held that the mortgage took priority over the federal tax liens (Pet. App. 3). Under Sections 6323(a) and 6323(h)(1) of the Internal Revenue Code, an interest in property that is protected under local law against a "judgment lien" creditor (26 U.S.C. 6323(h)(1)) is entitled to priority against a later-filed federal tax

lien. See 26 U.S.C. 6323(a).[1] The bankruptcy court concluded that the mortgage lien satisfied this requirement because (i) no party had relied to its detriment on the erroneous release of the mortgage and (ii) state law provided for the reinstatement of an erroneously released mortgage lien in these circumstances (Pet. App. 3-4). The district court affirmed the bankruptcy court's decision (*id.* at 4).

2. The court of appeals reversed on two independent grounds (Pet. App. 1a-42a). First, the court held that it was irrelevant whether the government had knowledge of the erroneous release of the mortgage and would have been subject to equitable subordination under state law.[2] The court noted that, under Section 6323(a) and (h)(1) of the Code (with exceptions not here applicable), the federal tax lien takes priority (i) against security interests perfected after notice of the tax lien is filed and (ii) against any security interest that, before notice of the tax lien is filed, would have been subordinate to the interest of a hypothetical

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[1] Section 6323(a) establishes the general rule that a federal tax lien "shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor" until notice of the tax lien is properly filed. 26 U.S.C. 6323(a). Section 6323(h)(1) provides that "[a] security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth." 26 U.S.C. 6323(h)(1).

[2] Relying on Alabama Code § 35-4-90 (1991), which provides that unrecorded mortgages are inoperative against judgment creditors without notice, the court of appeals held (Pet. App. 18 n.8) that the operative inquiry under Alabama law was notice and not detrimental reliance.

"judgment lien" creditor (Pet. App. 6-38). The court explained that a hypothetical judgment lien creditor would have prevailed against petitioner's unperfected mortgage interest on the date the federal tax liens were filed because the mortgage lien had been released before that date. The court held that the federal tax liens were therefore entitled to priority under the applicable federal law (*id.* at 29).

The court of appeals further held retroactive reinstatement of the mortgage lien would, in any event, be ineffective against the federal tax liens. Although, in various factual situations, state law sometimes recognizes the fiction of "retroactive" perfection, federal law does not permit such state fictions retroactively to divest the federal lien of its statutory priority (Pet. App. 38-40, citing 26 C.F.R. 301.6323(h)-1(a)(2)).[3] The court stated that the

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[3] 26 C.F.R. 301.6323(h)-1(a)(2)(i) provides in pertinent part:

> For purposes of this paragraph, a security interest is deemed to be protected against a subsequent judgment lien on—
>
> > (A) The date on which all actions required under local law to establish the priority of a security interest against a judgment lien have been taken, or
> >
> > (B) If later, the date on which all required actions are deemed effective, under local law, to establish the priority of the security interest against a judgment lien.
>
> For purposes of this subdivision, the dates described in (A) and (B) of this subdivision (i) shall be determined without regard to any rule or principle of local law which permits the relation back of any requisite action to a date earlier

equitable reinstatement of the mortgage lien by the bankruptcy court, and the associated retroactive assertion of priority over the federal tax liens, was "precisely the * * * type of relation back principle which the Regulations forbid" (Pet. App. 40).

ARGUMENT

The court of appeals correctly held that the federal tax liens involved in this case have priority over the reinstated mortgage lien. This decision does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Under Alabama law, the release extinguished the mortgage lien. Ala. Code § 35-10-28 (1991). The subsequent equitable reinstatement of the mortgage lien under state law permitted the mortgagee to perfect its interest against intervening judgment lien creditors. The steps required to revive the mortgage lien were not taken, however, until *after* the notice of the federal liens had been filed in this case (Pet. App. 40).

The court of appeals correctly concluded (Pet. App. 40) that a federal tax lien may not be divested of the priority established for it under federal law by state-law principles that "retroactively" impose a lien based upon events that occur *after* the federal priority is established. Under 26 C.F.R. 301.6323(h)-1(a)(2)(i), the tax lien's priority must be determined "without regard to any rule or principle of local law which permits the relation back of any requisite action to a date earlier than the date on which the action is actually

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than the date on which the action is actually performed. * * *

performed." Cf. *United States* v. *Irvine*, 114 S. Ct. 1473, 1481-1482 (1994).

Petitioners err in contending (Pet. 25-26) that *Manalis Finance Co.* v. *United States*, 611 F.2d 1270 (9th Cir. 1980), holds to the contrary. The court in *Manalis* addressed whether a particular provision of state law (relating to the State's lien with respect to certain medical-care payments) had the effect of providing priority for federal tax claims over *previously perfected* private liens in such payments. See *id.* at 1273. Contrary to petitioners' suggestion (Pet. 25), the court in *Manalis* did not even consider, much less resolve, whether a lien that is released may thereafter be "equitably" reinstated with priority over an intervening federal tax lien.[4] There is thus no conflict or other reason warranting further review of the court's holding on this issue in this case.

2. The court of appeals further correctly held (Pet. App. 5) that, on the date that the notice of tax lien is filed, the federal tax lien takes priority over any interest in the property that was then subordinate to the interest of a hypothetical "judgment lien" creditor (26 U.S.C. 6323(h)(1)). The court explained that the priority of the federal tax lien is tested by the priority of a hypothetical "judgment lien" creditor, not by the

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[4] *United States* v. *McDermott*, 113 S. Ct. 1526 (1993), and *United States* v. *City of New Britain*, 347 U.S. 81 (1954), on which petitioners erroneously rely (Pet. 27-28), do not involve the question whether private liens that were not perfected at the time the federal liens were filed may "retroactively" be given priority under state law. Moreover, petitioners' suggestion that the bank's interest was "perfected" under state law at the time the federal tax liens were filed simply ignores the fact that the filing of the release had extinguished the mortgage lien (Ala. Code § 35-10-28 (1991)).

priority that the government would have if *the government* were the judgment creditor. That the government might, or might not, have notice of the facts leading to the release of the mortgage is therefore irrelevant (Pet. App. 22).

As the court noted, the statute affords priority only for a security interest that "has become protected under local law against *a* subsequent judgment lien" (Pet. App. 22, quoting 26 U.S.C. 6323(h)(1) (emphasis added by court)). Because the priority statute relates the rights of the United States to the rights that a "judgment lien" creditor would have, rather than to the rights the United States would have if *it* were a judgment lien creditor, the court concluded that the priority of the federal lien is to be tested by the rights of a hypothetical "judgment lien" creditor. Because the mortgage lien was not protected against the hypothetical intervening judgment lien creditor that lacked notice of the erroneous release, the court concluded that the federal tax lien has priority in this case under 26 U.S.C. 6323(h)(1) (Pet. App. 20).

As the court noted, the hypothetical judgment lien creditor test fulfills the purpose of the statute by "promoting certainty and stability in business affairs for secured creditors" (Pet. App. 23). By contrast, the approach advocated by petitioners would require a case-by-case inquiry into whether the government had notice of (or relied to its detriment on) an unperfected interest. Petitioners' test is thus inconsistent with the language of the statute and "would undermine the certainty and stability" of the statutory scheme (*ibid.*). Accord *Dragstrem* v. *Obermeyer*, 549 F.2d 20, 26 (7th Cir. 1977); *General Electric Credit Corp.* v. *Isaacs*, 581 P.2d 1032, 1037 (Wash. 1978).

Petitioners err in contending (Pet. 20-21) that the court's application of the hypothetical judgment lien creditor test in this case conflicts with *United States* v. *Trigg*, 465 F.2d 1264, 1268-1269 (8th Cir. 1972), cert. denied, 410 U.S. 909 (1973), *Manalis Finance Co.* v. *United States*, *supra*, and *United States* v. *Ed Lusk Construction Co.*, 504 F.2d 328, 331 (10th Cir. 1974). The court of appeals thoroughly discussed those decisions and correctly concluded that they do not conflict with its holding in this case (Pet. App. 29-36).[5]

In particular, *United States* v. *Trigg* and *United States* v. *Ed Lusk Construction Co.* do not hold that an unperfected security interest takes priority over a federal tax lien when the government has knowledge of the unperfected interest. Instead, as the court correctly stated in this case (Pet. App. 29-33), those decisions conclude that the government did *not* have knowledge of the unperfected interest and therefore did not reach the question whether such knowledge would be relevant.[6] The Ninth Circuit's decision in

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[5] In the process, the Eleventh Circuit correctly rejected the suggestion in *Metropolitan National Bank* v. *United States*, 901 F.2d 1297, 1301 n.1 (5th Cir. 1990), that the approach in *Trigg* and *Ed Lusk Construction Co.* diverged from the approach adopted in *Dragstrem*.

[6] The Eleventh Circuit also correctly observed (Pet. App. 36-37) that the Sixth Circuit's decision in *Citizens State Bank* v. *United States*, 932 F.2d 490 (1991), did not reject the hypothetical judgment lien creditor test. In that case, the court of appeals applied Kentucky law in concluding that an erroneously released mortgage lien could not prevail against a subsequent federal tax lien. The decision was based upon the fact that the IRS lacked knowledge that the lien had been released in error. See *id.* at 494-495. Because the IRS lacked knowledge that the lien had been released in error, the Sixth

Manalis also did not hold that an unperfected security interest may take retroactive priority over a federal tax lien; in that case, the competing security interest took priority because it had been properly and timely perfected before notice of the tax lien was filed. See 611 F.2d at 1273.

Even if there were a conflict among the courts of appeals on the question whether the knowledge of the government is relevant in applying the "judgment lien" creditor test of Section 6323(h)(1), the present case is not an appropriate vehicle to resolve the claimed conflict. As the court of appeals expressly noted, the court's holding that 26 C.F.R. 301.6323(h)-1(a)(2) bars retroactive application of the state-law doctrine of "equitable reinstatement" is an alternative, independent ground for the judgment in this case (Pet. App. 5). There is unquestionably no conflict on that issue to warrant further review.

Petitioners err in contending (Pet. 24-25) that, under the hypothetical judgment lien creditor test, a federal tax lien would prevail even against prior perfected security interests. The decision in this case does not support such a broad proposition. The court's decision addresses only security interests that are not perfected at the time notice of the federal lien is filed. It has no application to security interests that *are* perfected and valid when the notice of federal lien is filed.[7]

Circuit had no occasion to consider the merits of the hypothetical judgment lien creditor test.

[7] Petitioners' contention (Pet. 13-14) that the court of appeals improperly focused on "notice" as opposed to "detrimental reliance" in applying the hypothetical judgment lien creditor test (see note 2, *supra*) is beside the point. Even if the

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

DAVID ENGLISH CARMACK
EDWARD T. PERELMUTER
Attorneys

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operative inquiry under Alabama law were detrimental reliance, the government would prevail under the hypothetical judgment lien creditor test.